



Skin Elements Limited
ASX ANNOUNCEMENT

ASX CODE:SKN

28 October 2019

Ms Penelope Reid
Advisor, Listings Compliance (Perth)
Australian Stock Exchange

Dear Penelope

Skin Elements Limited (SKN) – Queries regarding Accounts

In response to your letter of 21 October 2019, Skin Elements Limited advised as follows:

1. Is SKN able to confirm that in the Directors' Opinion the Full Year Accounts:

- (a) comply with the relevant Accounting Standards; and**
- (b) give a true and fair view of SKN's financial performance and position?**

SKN confirms that in the Directors opinion, the financial statements for the year ended 30 June 2019 (2019 FYR):

- (a) Comply with the relevant Accounting Standards; and
- (b) Give a true and fair view of SKN's financial performance and position.

We note that the qualification matter described in the Basis for Qualified Conclusion arose as the auditor was not able to obtain sufficient appropriate audit evidence that SKN's Intangible assets recoverable amount was not lower than its carrying value as reported in the 2019 FYR, rather than a qualification stating that the accounts had not complied with AASB 136 or any other relevant Accounting Standards.

2. Please explain the basis for and the factors considered by the Directors to satisfy themselves that future cashflows that were included in the impairment model were appropriate?

Included in Skin Elements' 2019 Audited Annual Report is an intangible asset carrying amount of \$8,995,117 being the historical capitalised development costs and acquisition costs of the Company's natural skincare formula and technologies. The Company has commenced commercialisation of these technologies and according has commenced amortisation of these costs. Details are set out in the notes to the annual report with the \$6,052,125 of the carrying amount attributable to the Soleo

Natural Science by Skin Elements

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www.mcarthurskincare.com
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Organics sunscreen range, \$817,310 to pawpaw based skincare range and \$2,125,683 to EJNC natural cosmetics range.

As required under AASB 136, forecast cashflows were prepared by management to determine the intangible asset impairment model. In addition to the continued development of its existing Australian and internal distributor sales channels and the Company's online sales channels, these projections assumes Skin Elements successfully completing negotiations with major international customers for the sale and delivery of Skin Elements' significantly expanded natural skincare and suncare product ranges into those markets.

These major contracts include a major UK retail chemist chain, development of a major online retailer in the USA, and a China distribution agreement as announced to the market on 25 March 2019. These forecasts were supported by documentation as to the promising on-going negotiations with these prospective customers.

Although the board are confident that these negotiations will lead to major sales contracts, as at the date of signing the 2019 audited annual report there were no signed contracts in place.

On 9 October 2019, SKN announced that despite significant effort by both parties and advisors, initial convertible loan note deposit of \$200,000, and initial order of \$300,000 for product delivered into China, the parties were not able to reach agreement on a number of matters, among these being the form of guarantee for the delivery of the minimum sales orders as set out in the terms of the Distribution Agreement and therefore it would not be proceeding with the HHHM distribution and strategic investment agreements. The decision not to proceed with this agreement changes certain revenue and costs projection details of the cashflow projections, however, does not adversely effect the outcomes of the assessment of carrying value or going concern. The Company's cashflow projections, excluding the HHHM transactions, provides for sufficient future revenue amounts to support the recoverability of the carrying value of the Company's intangible assets.

Management and directors are involved in day to day negotiations with these customers and are confident of their success however the Company was unable to provide the auditors with signed agreements or confirmed orders as at the date of the audit report as evidence as to the commercialisation proceeding.

In relation to the assessment of the carrying value of intangible assets members of the Board actively reviewed the cashflow forecasts and the underlying key assumptions supporting those forecasts. Members of the Board also directly attended meetings with and participated in negotiations with opportunities for development of the business which provided a first hand understanding of the underlying assumptions in the cashflow forecast model.

The Directors believe that the cashflow projections they used to justify the recoverable amount of these assets are reasonable and reliable forecasts and that the requirements of AASB 136 have been fully complied with.

3. Given the Auditor has identified a material uncertainty that may cast significant doubt about SKN's ability to continue as a going concern and SKN has cash and cash equivalents of \$116,238 and total current liabilities of \$706,208, on what basis do the directors consider that SKN is a going concern?

For the year ended 30 June 2019 the Group recorded a loss of \$1,967,761, cash & receivables of \$791,379, inventories & work in progress of \$114,857, trade payables of \$506,208 and borrowings of \$200,000 giving a net working capital surplus of \$200,028.

As set out in the Annual Report, the ability of the entity to continue as a going concern is dependent on securing additional funding through issue of debt or equity, increasing revenues from sale of the Group's products and R&D tax rebates to continue to fund its operational and marketing activities.

Management believe there are sufficient funds to meet the entity's working capital requirements and as at the date of this report.

Subsequent to year end the entity received R&D tax rebate funds of \$483,000, and the balance of \$113,675 of the equity placement.

4. What steps has SKN taken since the release of the Full Year Accounts to obtain an unqualified opinion with regards to its future financial statements?

The Directors are confident that the increased sales of Company's expanded natural skincare product range into existing sales distribution and online channels and the progressing of the major opportunities with the UK and US customers will validate the reliability of SKN's cash flow models used to support the recoverable amount of the intangible assets of \$8,995,117.

The Directors anticipate that they will be able to satisfy the auditor during the financial year 2020 that the models used to determine the recoverable amount of the asset are reliable and will receive an unqualified audit opinion.

5. When will the rights issue, referred to in the Announcement, be announced?

This is underway and expected to be announced in November.

6. Has SKN paid Mr Li's \$200,000 given seven days have elapsed?

No

7. If the answer to the above question is "no", given SKN has \$116,238 (recorded in the Full Year Accounts) and Mr Li is demanding repayment of \$200,000 within 7 days, what steps will be taken to fund repayment?

The Company believes that the convertible note of \$200,000 is repayable on or before 31 December 2019 as set out in the signed Term Sheet, although Mr Li is seeking repayment within seven days. The Company has been in communication with Mr Li on a number of matters including the repayment of the \$200,000. The Company has sufficient cash to repay this amount.

8. Does SKN consider that its level of operations is sufficient to warrant continued quotation of its securities on ASX as required under listing rule 12.1? In answering this question, please explain the basis for this conclusion. In answering this question, please comment on the nature of the SKN's current business activities.

SKN considers that its level of operations is sufficient to warrant continued listing on ASX as required under Listing Rule 12.1.

The Group has developed a suite of over 40 proprietary formula all natural skincare products and is pursuing significant opportunities to develop and grow its business of commercialising these products. Over the past decade, these products have achieved over \$25 million in test market sales and SKN firmly believes that it will be able to continue to execute its stated business plan of producing and selling its expanded natural skincare product range.

As set out in the Company's Annual Report, Skin Elements business focus is :

- Achieving positive cashflows from securing major distribution agreements.
- Raising additional equity to contribute to the Group working capital position in the near term.

9. Does SKN consider that the financial condition of SKN is sufficient to warrant continued listing on ASX as required under Listing Rule 12.2? In answering this question, please also explain the basis for this conclusion.

SKN considers that the financial condition of SKN is sufficient to warrant continued listing on ASX as required under Listing Rule 12.2.

As detailed in 3 above, SKN is in a positive working capital position, and Management believe there are sufficient funds to meet the entity's working capital requirements.

SKN has a net asset position of \$9.195 million.

10. If the answer to questions 8 or 9 is "No", please explain what steps SKN has taken, or proposes to take, to warrant continued listing on ASX under the requirements of Listing Rules 12.1 and 12.2.

Not applicable

11. In relation to the Full Year Report, did the Board receive the CFO and CEO declaration, as described in section 4.2 of SKN's Corporate Governance Disclosure, that in the opinion of the CFO and CEO, the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of SKN and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively?

Yes, the Chief Financial Officer and the Executive Chairman have confirmed that the financial reporting risk management and associated compliance and controls have been assessed and the adequacy of the system of risk oversight, management and internal control.

Skin Elements Limited has a formally established Audit and Risk Committee. The purpose of the Committee is to provide assistance to the Board in fulfilling its corporate governance and oversight responsibilities, as well as advise on the modification and maintenance of the Company's financial reporting, internal control structure, risk management systems, external audit functions, and appropriate ethical standards for the management of the Company.

The Board and Committee take a proactive approach to risk management. The identification and proper management of risk within SKN is a priority for the Company.

The Committee is responsible for oversight of the processes whereby risks, and also opportunities, are identified on a timely basis and the Company's objectives and activities are aligned with the risks and opportunities identified and recommendations made to the Board.

The Company has sought to minimize business risks by focusing on the Company's core business. The Board and Committee are responsible for ensuring that the Company's risk management systems are adequate and operating effectively.

An annual review of the Company's risk profile is undertaken by the Committee and any material changes to the risk profile are noted. To assist the Committee to conduct the annual review, management and key executives are required to report on any material risks identified, how the risks are being managed, the implementation of any risk management or internal control system, and whether any breaches of the risk management policies have occurred during the preceding 12 months

12. If the answer to Question 11 is 'no', why did the Board not receive the CEO and CFO declaration as described in section 4.2 of SKN's Corporate Governance Disclosure?

Not applicable.

13. What enquiries did the Board make of management to satisfy itself that the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of SKN?

The Board of Directors makes regular and direct inquiry of the management of the Group to satisfy itself that the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give true and fair view of the financial position and performance of SKN.

Separately, SKN has an established audit committee which continually reviews operations, internal systems and management accounts to ensure that the financial statements give a true and fair view of the financial position and performance of SKN.

14. Commenting specifically on the qualified opinion, does the board consider that SKN has a sound system of risk management and internal control which is operating effectively?

The Board believes that SKN has a sound system of risk management and internal control which is operating effectively.

Management has produced detailed cashflow models to support the recoverable amounts of its intangibles, the models show that the intangible assets recoverable amount is well in excess of its carrying value.

All of the Company's intellectual property (intangibles assets) are being actively commercialised.

15. Please confirm that SKN is complying with the Listing Rules and, in particular, Listing Rule 3.1.

We confirm that SKN is complying with the Listing Rules and, in particular, Listing Rule 3.1.

16. Please confirm that SKN's responses to the questions above have been authorised and approved under its published continuous disclosure policy or otherwise by its board or an officer of SKN with delegated authority from the board to respond to ASX on disclosure matters.

We confirm that SKN's responses to the questions above have been authorised and approved under its published continuous disclosure policy.

Yours sincerely



Craig Piercy
Company Secretary



21 October 2019

Mr Craig Piercy
Company Secretary
Skin Elements Limited
7/36 Ord Street
WEST PERTH WA 6005

By email: craig@senatural.com

Dear Mr Piercy

Skin Elements Limited ("SKN"): Queries regarding Accounts and recent update SKN update

ASX refers to:

- A. SKN's full year accounts for the full year ended 30 June 2019 lodged with ASX Market Announcements Platform and released on 1 October 2019, with an amended version lodged on 3 October 2019 ("Full Year Accounts").
- B. ASX notes that the Independent Auditor's Report attached to the Full Year Accounts ("Auditor's Report") contains a qualified opinion together with the basis for qualified opinion:

"Qualified opinion

We have audited the financial report of Skin Elements Limited (the Company) and its subsidiaries (the Group), which comprises the consolidated statement of financial position as at 30 June 2019, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the financial report, including a summary of significant accounting policies and the directors' declaration.

In our opinion, except for the effects of the matter described in the Basis for qualified opinion section of our report, the accompanying financial report of the Group, is in accordance with the Corporations Act 2001, including:

- (i) Giving a true and fair view of the Group's financial position as at 30 June 2019 and of its financial performance for the year ended on that date; and*
- (ii) Complying with Australian Accounting Standards and the Corporations Regulations 2001.*

Basis for qualified opinion

Included in the consolidated statement of financial position as at 30 June 2019 is technology and formula Intangible assets of \$8,995,117 as disclosed in note 9 and note 1(p)(i). Due to sustained operating losses, the Group has undertaken an impairment assessment of its Intangible in accordance with AASB 136 Impairment of assets.

Due to the significant variability of the future cash flows of the asset, we were unable to satisfy ourselves as to the appropriateness and reliability of the forecast of future cashflows that was included in the impairment model. Therefore we were unable to obtain sufficient appropriate audit evidence about the carrying value of the Intangible assets as at 30 June 2019.

Consequently we were unable to determine whether any adjustments to the carrying value of the Intangible asset in the statement of financial position are necessary for the year ended 30 June 2019.

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the Financial

Report section of our report. We are independent of the Group in accordance with the Corporations Act 2001 and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We confirm that the independence declaration required by the Corporations Act 2001, which has been given to the directors of the Company, would be in the same terms if given to the directors as at the time of this auditor's report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Emphasis of matter – Material uncertainty relating to going concern

We draw attention to Note 1(c) in the financial report which describes the events and/or conditions which give rise to the existence of a material uncertainty that may cast significant doubt about the Group's ability to continue as a going concern and therefore the Group may be unable to realise its assets and discharge its liabilities in the normal course of business. Our conclusion is not modified in respect of this matter."

- C. SKN's Corporate Governance Statement for 2019 lodged on the ASX Market Announcements Platform on 1 October 2019 which provides confirmation that SKN complies with recommendation 4.2 of the ASX Corporate Governance Principles and Recommendations which states:

"The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that, in their opinion, the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively."

- D. SKN's announcement of 9 October 2019 titled "China Distribution Agreement Not Proceeding" which states the following:

- (i) in relation to the "proposed Sale and Distribution Agreement ... with Henan Huatuo Health Management Co Ltd" that the "convertible note of \$200,000 is repayable on or before 31 December 2019 though Mr Li is seeking repayment within seven days";
- (ii) that "Notwithstanding that the proposed and now terminated Agreement with HHHM would have assisted in supporting the reliability of Skin Elements' cashflow projections and that there are currently no signed major sales contracts in place, the Board and management are confident that the ongoing sales negotiations will lead to major contracts..."; and
- (iii) that the Company will "be undertaking a fully underwritten non renounceable rights issue to raise approximately \$1 million working capital to support production of stock, with details to be announced once finalised", ("Announcement").

- E. Listing Rule 12.1 which states:

12.1 *The level of an entity's operations must, in ASX's opinion, be sufficient to warrant the continued +quotation of the entity's +securities and its continued listing.*

- F. Listing Rule 12.2 which states:

12.2 An entity's financial condition (including operating results) must, in ASX's opinion, be adequate to warrant the continued quotation of its securities and its continued listing.

G. Listing Rule 19.11A which states:

19.11A If a listing rule requires an entity to give ASX accounts, the following rules apply.

- (a) If the entity controls an entity within the meaning of section 50AA of the Corporations Act or is the holding company of an entity, required by any law, regulation, rule or accounting standard, or if ASX requires, the accounts must be consolidated accounts.
- (b) The accounts must be prepared to Australian accounting standards. If the entity is a foreign entity the accounts may be prepared to other standards agreed by ASX.
- (c) If the listing rule requires audited accounts, the audit must be conducted in accordance with Australian auditing standards by a registered company auditor. If the entity is a foreign entity, the audit may be conducted in accordance with other standards agreed by ASX and may be conducted by an overseas equivalent of a registered company auditor.
- (d) If the listing rule requires accounts to be reviewed, the review must be conducted in accordance with Australian auditing standards. If the entity is a foreign entity, the review may be conducted in accordance with other standards agreed by ASX. Unless the listing rule says an independent accountant may conduct the review, it must be conducted by a registered company auditor (or, if the entity is a foreign entity, an overseas equivalent of a registered company auditor).
- (e) If there is a directors' declaration that relates to the accounts, the directors' declaration must be given to ASX with the accounts.
- (f) If there is a directors' report that relates to the period covered by the accounts, the directors' report must be given to ASX with the accounts.

Request for Information

In light of the information contained in the Full Year Accounts and the Auditor's Report, and the application of the Listing Rules stated above, please respond to each of the following questions:

1. Is SKN able to confirm that in the Directors' Opinion the Full Year Accounts:
 - (a) comply with the relevant Accounting Standards; and
 - (b) give a true and fair view of SKN's financial performance and position?
2. Please explain the basis for and the factors considered by the Directors to satisfy themselves that future cashflows that were included in the impairment model were appropriate?
3. Given the Auditor has identified a material uncertainty that may cast significant doubt about SKN's ability to continue as a going concern and SKN has cash and cash equivalents of \$116,238 and total current liabilities of \$706,208, on what basis do the directors consider that SKN is a going concern?
4. What steps has SKN taken since the release of the Full Year Accounts to obtain an unqualified opinion with regards to its future financial statements?
5. When will the rights issue, referred to in the Announcement, be announced?
6. Has SKN paid Mr Li's \$200,000 given seven days have elapsed?

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7. If the answer to the above question is “no”, given SKN has \$116,238 (recorded in the Full Year Accounts) and Mr Li is demanding repayment of \$200,000 within 7 days, what steps will be taken to fund repayment?
 8. Does SKN consider that its level of operations is sufficient to warrant continued quotation of its securities on ASX as required under listing rule 12.1? In answering this question, please explain the basis for this conclusion. In answering this question, please comment on the nature of the SKN’s current business activities.
 9. Does SKN consider that the financial condition of SKN is sufficient to warrant continued listing on ASX as required under Listing Rule 12.2? In answering this question, please also explain the basis for this conclusion.
 10. If the answer to questions 8 or 9 is “No”, please explain what steps SKN has taken, or proposes to take, to warrant continued listing on ASX under the requirements of Listing Rules 12.1 and 12.2.
 11. In relation to the Full Year Report, did the Board receive the CFO and CEO declaration, as described in section 4.2 of SKN’s Corporate Governance Disclosure, that in the opinion of the CFO and CEO, the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of SKN and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively?
 12. If the answer to Question 11 is ‘no’, why did the Board not receive the CEO and CFO declaration as described in section 4.2 of SKN’s Corporate Governance Disclosure?
 13. What enquiries did the Board make of management to satisfy itself that the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of SKN?
 14. Commenting specifically on the qualified opinion, does the board consider that SKN has a sound system of risk management and internal control which is operating effectively?
 15. Please confirm that SKN is complying with the Listing Rules and, in particular, Listing Rule 3.1.
 18. Please confirm that SKN’s responses to the questions above have been authorised and approved under its published continuous disclosure policy or otherwise by its board or an officer of SKN with delegated authority from the board to respond to ASX on disclosure matters.

When and where to send your response

Please note that ASX reserves its right under Listing Rule 18.7A to release this letter and SKN’s response to the market. Accordingly, SKN’s response should address each question separately and be in a format suitable for release to the market.

Unless the information is required immediately under Listing Rule 3.1, a response is requested as soon as possible and, in any event by no later than **2 pm AWST Monday, 28 October 2019**.

Any response should be sent to me by return email at ListingsCompliancePerth@asx.com.au. It should not be sent to the ASX Market Announcements Office.

Enquiries

If you have any queries regarding any of the above, please contact me.

Yours sincerely

Penelope Reid
Adviser, Listings Compliance (Perth)